Punitive Damages in Arbitration: The Second Circuit on a Collision Course with the U.S. Supreme Court

I. INTRODUCTION

This Note is an analysis of how federal courts have dealt with the issue of whether arbitrators are empowered to award punitive damages. The first section of the Note is a discussion of the Second Circuit case, *Fahnestock v. Waltman*,[1] which denied such power to arbitrators. The second section notes the differences on this issue among the circuits. The next two sections serve as background explanation of the Federal Arbitration Act (FAA) and arbitration of commercial and labor disputes. The last section discusses the conflict between the Second Circuit and the other federal circuits on this issue. I conclude that the Second Circuit's reasoning in recent cases discloses an intent to deprive arbitrators of the power to award punitive damages in derogation of Supreme Court precedent to the contrary.

II. FAHNESTOCK V. WALTMAN

A. *The* Fahnestock *Decision*

Fahnestock hired Waltman on March 16, 1982 as a "registered representative to head Fahnestock's Retirement Trust Division"[2] and "to manage and build Fahnestock's insurance products business."[3] Waltman acted as an insurance sub-licensee to Fahnestock. He also established a general insurance agency in Pennsylvania to market insurance and annuity products for Fahnestock. Waltman was fired by Fahnestock on December 12, 1988, when Fahnestock closed its Retirement Trust Division.[4]

Upon firing Waltman, Fahnestock filed a Form U-5 termination notice with the National Association of Securities Dealers (NASD) that indicated that the discharge resulted from "business consolidation."[5] Later, Fahnestock noticed that some files were missing and asked Waltman to return them. Waltman refused because he thought that the files

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1. Fahnestock & Co., Inc. v. Waltman, 935 F.2d 512 (2d Cir.), *cert. denied*, 112 S. Ct. 380 (1991).

2. *Id.* at 514.

3. *Id.*

4. *Id.*

5. *Id.*

belonged to the general insurance agency. Waltman said that he would furnish Fahnestock with the files if Fahnestock obtained a release and indemnification from each registered agent named in the files.[6]

Waltman's response led Fahnestock to do two things. Fahnestock filed a request with the New York Stock Exchange to get the files from Waltman and then filed an amended Form U-5. In the amended form, Fahnestock changed an answer to one of the questions to indicate that Waltman was under "internal review for fraud or wrongful taking of property, or violating investment-related statutes, regulations, rules or industry standards of conduct."[7]

An arbitration took place in which Waltman denied Fahnestock's claim and counterclaimed that Fahnestock, and three company officers, had defamed him by filing the amended Form U-5. After eight hearings, which included testimony that Fahnestock had threatened Waltman in an attempt to get the defamation action dropped, the arbitrators awarded Waltman $56,000 in compensatory damages for wrongful discharge, $14,700 in legal fees, $100,000 for defamation, and $100,000 in punitive damages.[8] This award applied only to Fahnestock, as the actions against the other corporate officers were dismissed.

Fahnestock filed a petition to have the award vacated while Waltman filed an action to confirm the award. Waltman's action was stayed pending the outcome of the petition to vacate. The district court vacated the arbitrator's award of damages.[9]

The central issue on appeal focused upon the lack of specified remedies in the arbitration agreement. A majority of the Second Circuit reasoned that since punitive damages were not specified, state law governed the appropriate relief to be read into the agreement because the jurisdictional basis of the federal court action was diversity of citizenship.[10] Judge Miner, writing for the majority, cited United States Supreme Court precedent for the proposition that the propriety of punitive damages is a matter of state law when the federal court's jurisdiction is based upon diversity.[11]

Having laid the theoretical basis for applying state law, the court proceeded to examine the arbitration agreement itself. The most important

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6. *Id.*

7. *Id.*

8. *Id.*

9. *Id.* at 515.

10. *Id.* at 518.

11. *Id.* (citing Browning-Ferris Indus. v. Kelco Disposal, Inc., 492 U.S. 257, 278 (1989)).

fact concerning the arbitration agreement was the absence of an explicit sanction of the punitive damages remedy. The court implied that such an inclusion "may" have changed the outcome. The court scrutinized the New York Stock Exchange's (N.Y.S.E.) constitution to discover if it dealt with punitive damages. The court found no mention of such relief, although the court did cite some board provisions of the constitution regarding disposition of claims.[12]

The court pointed out that this case did not involve an arbitration agreement that incorporated the rules of the American Arbitration Association (AAA). The court found that fact significant because the AAA has a broad clause that has been cited as authority for the power of arbitrators to award punitive damages. The court stated that if the N.Y.S.E. had wanted to allow arbitrators to award punitive damages then it should have made that clear, for such an allowance was well within its power.[13]

Having found that the agreement did not provide for punitive damages and the FAA does not preempt state law in this matter, the court looked to state law to determine whether punitive damages were available. Relying upon *Garrity v. Lyle Stuart, Inc.*, the court in *Fahnestock* held that punitive damages were not arbitrable.[14] As a result, the court affirmed the *vacatur* of the punitive damages award.

B. Mahoney in Dissent

Judge Mahoney dissented from the majority's affirmance of the *vacatur* of the punitive damages award. Mahoney asserted that the majority's reasoning had two faults. Mahoney criticized the majority for misinterpreting the status to be accorded the FAA.[15] Secondly, Mahoney viewed the court's virtually exclusive focus on *Garrity* as skipping a step in the proper analysis.[16] The proper focus, in Mahoney's view, should have been on the intent of the parties: was it their intent that punitive

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12. *Id.* at 518-19.

13. *Id.* at 519.

14. *Id.* at 517. New York's Court of Appeals held that an arbitrator does not have the power to award punitive damages even when the parties agree upon it. Garrity v. Lyle Stuart, Inc., 353 N.E.2d 793, 795 (N.Y. 1976). The court reasoned that "enforcement of an [arbitrator's] award of punitive damages as a purely private remedy would violate strong public policy." *Id.* In essence, *Garrity* held that the power to award punitive damages was one reserved to the courts.

15. *Fahnestock*, 935 F.2d at 519 (Mahoney, J., dissenting).

16. *Id.* at 520.

damages claims would be arbitrated?[17]

Mahoney's first argument was that the FAA is a unique substantive law which curiously does not automatically accord independent federal subject matter jurisdiction. There must be some other basis for subject matter jurisdiction for the case to be heard in federal court. However, Mahoney believed that the FAA was substantive law and was applicable to the issue in this case:

> The majority's approach effectively disregards the existence of a "body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate," and imposes the diversity regime of Erie R.R. v. Tompkins, 304 U.S. 64 (1938). The *Erie* standard is intended, however, for "all matters except those in which some federal law is controlling." *Id.* at 72. It therefore seems to me clearly inappropriate to apply *Erie*-generated rules to an area for which, the Supreme Court has instructed, federal law supplies the rule of decision.[18]

Mahoney's second point, and perhaps the most important one in his eyes, was that the agreement itself should have been examined.[19] Mahoney was disconcerted that the majority gave short shrift to the fact that the arbitrator award form used by the N.Y.S.E. makes an express provision for the allowance of punitive damages.[20] For Mahoney, this treatment was representative of the blind adherence to *Garrity* in derogation of all other issues.

At the very least, the United States Supreme Court precedent on the construction of arbitration clauses, which sanctioned federal arbitrators' use of punitive damages, and the existence of some evidence that punitive damages were contemplated by the parties in the instant case, should have led the court to examine the issue more closely.[21] At a minimum, the court should have sent the case back to the district court for an examination of the parties' contractual intent *vis à vis* resolution of punitive damages claims. Mahoney did not conclude that the outcome of such a remand would differ from the result reached by the majority, but

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17. *Id.* at 521.

18. *Id.* at 520 (quoting Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 25 n.32 (1982)).

19. *Id.* at 520 (Mahoney, J., dissenting).

20. *Id.* at 521.

21. *Id.*

Mahoney did believe that the analysis should have been made.[22]

III. FEDERAL CIRCUIT COURTS

The Second Circuit alone has determined that state law concerning an arbitrator's power to award punitive damages is controlling in the absence of explicit contractual authorization. The other circuits that have addressed this issue have invoked the broad policy concerns underpinning the FAA in upholding arbitrators' awards of punitive damages. For the other circuits, the FAA is controlling even when the parties have chosen to be governed by the law of a state which does not allow arbitrators to award punitive damages.

A. Ninth Circuit

The most recent circuit court to consider the issue of punitive damages in the commercial arbitration context is the Ninth Circuit in *Todd Shipyards Corp. v. Cunard Line, Ltd.*[23] The Ninth Circuit was presented with a commercial arbitration pursuant to a contractual clause between a contractor, Todd Shipyards, and Cunard, the company which employed Todd Shipyards to repair a ship. The dispute originated when Todd Shipyards was unable to complete the contract for repair within the time prescribed by the contract. Todd asserted, among other things, that Cunard failed to provide the plans and specifications as provided in the contract. This lack of performance by Cunard allegedly caused the delay and caused Todd Shipyards to incur additional costs to repair the ship.[24] The arbitration agreement included in the contract between the parties was based on the American Arbitration Association rules. These rules and the contract in question included a broad provision allowing the arbitrator to award "any remedy or relief which is just and equitable and within the terms of the agreements of the parties."[25]

In addition to this provision, the contract included a choice of law provision designating New York law as applicable to the contract. Cunard argued that under *Volt Information Sciences, Inc. v. Board of Trustees of*

22. *Id.* at 522.

23. 943 F.2d 1056 (9th Cir. 1991).

24. *Id.* at 1058-59.

25. *Id.* at 1062-63 (quoting *Commercial Rules of the American Arbitration Association*, Rule 43 - Scope of the Award).

Leland Stanford Junior University,[26] when a state choice of law provision is included in a contract, state arbitration rules are to be followed. Thus, since New York law prohibits arbitrators from awarding punitive damages (*Garrity*), Todd could not recover them.[27] The court countered that Cunard's argument misinterpreted *Volt*, and that *Volt* stood for the proposition that federal courts will not disturb a state court's determination that a choice of law provision indicates the parties meant for state arbitration rules to apply.[28]

Having disposed of the choice of law problem, the court summarily held that federal law was controlling in cases subject to the FAA.[29] At this point, the court analyzed the state of punitive damages under federal law. The court dismissed the trend in labor arbitration cases that have held that punitive damages are available only when the contract expressly provides for them.[30] Citing the First and Eleventh Circuits, as well as various district courts, the Ninth Circuit concluded that the federal policy in favor of broad arbitrability sustained the arbitrator's power to award punitive damages.[31]

The *Todd* court noted the *Fahnestock* holding and distinguished it from the other circuits that allowed arbitrators to award punitive damages.[32] The court found the inclusion of the AAA rules to be dispositive on the issue of arbitrability of punitive damages because the AAA had an expansive remedies clause. The *Fahnestock* agreement, on the other hand, did not contain such a clause.[33]

B. Eleventh Circuit

In 1988, the Eleventh Circuit addressed the arbitration of punitive damages in *Bonar v. Dean Witter Reynolds, Inc.*[34] There, the court

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26. 489 U.S. 468 (1989).

27. *Todd Shipyards Corp.*, 943 F.2d at 1062.

28. *Id.*

29. *Id.* This case was subject to the FAA since the contract involved interstate commerce.

30. *See infra* Section V for the difference between labor and commercial arbitration.

31. *Todd Shipyards Corp.*, 943 F.2d at 1063. The court went on to judge the punitive damages award under New York law in terms of its appropriateness under the facts -- an analysis which had nothing to do with *Garrity*.

32. *Id.* at 1063, n.6.

33. *Id.* at 1062.

34. 835 F.2d 1378 (11th Cir. 1988).

vacated a punitive damages award because it was procured through fraud.[35] However, the court did set out the applicable law on arbitration of punitive damages to be applied on remand to a new arbitration panel.[36]

The facts in *Bonar*[37] are similar to those in *Todd*[38] in that the agreement incorporated the rules of the AAA (through choice of forum between N.Y.S.E. and AAA and others – the parties chose the AAA forum). The agreement also expressly designated New York law in its choice of law clause. The Eleventh Circuit invoked a prior decision in holding that the choice of law provision, in this case New York (which does not allow arbitrators to award punitives), does not vitiate the arbitrator's power under the FAA to award punitive damages.[39] The court discussed the impact of *Garrity* on their analysis:

> According to the *Willoughby* court, *Garrity* dealt only with the powers of arbitrators under state law and state public policy, and has no application in cases arising under the Arbitration Act (citation omitted). Thus, a choice of law provision in a contract governed by the Arbitration Act merely designates the substantive law that the arbitrators must apply in determining whether the conduct of the parties warrants an award of punitive damages; it does not deprive the arbitrators of their authority to award punitive damages.[40]

According to the *Bonar* court, contracts that allow for punitive damages, as evidenced here by inclusion of AAA rules, must take precedence over choice of law provisions where the state law would prohibit arbitrators from awarding the punitive damages. This conclusion is bolstered by the fact that the Supreme Court has instructed that "any doubts concerning the scope of arbitrable issues should be resolved in

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35. *Id.* at 1381. One of the witnesses for the plaintiff on the punitive damages issue perjured himself.

36. *Id.* at 1386-87.

37. *Id.* at 1379-80.

38. *Todd Shipyards Corp.*, 943 F.2d at 1058-59.

39. *Bonar*, 835 F.2d at 1387 (discussing Willoughby Roofing & Supply Co., Inc. v. Kajima International, Inc., 598 F. Supp. 353 (N.D. Ala. 1984), *affirmed*, 776 F.2d 269 (11th Cir. 1985)). The *Bonar* court understood *Willoughby* to stand as a "rule of construction for contracts that, on the one hand, authorize punitive damages in arbitration, and, on the other hand, call that authority into question with a choice of law provision. *Willoughby* tells us that in light of the federal policy that 'any doubts concerning the scope of the arbitrable issues should be resolved in favor of arbitration,' we must give precedence to the contract provisions allowing punitive damages." *Id.* (citations omitted).

40. *Id.* 835 F.2d at 1387.

favor of arbitration."[41]

C. First Circuit

The other circuit to consider this issue is the First Circuit, which held that arbitrators have the power to make punitive damages awards. In *Raytheon Co. v. Automated Business Systems, Inc.*[42] the First Circuit was presented with an arbitrator's award of punitive damages. The arbitration agreement between the two parties (one a dealer of the other's manufactured products) contained a clause which stated that "all disputes" arising from the contract "shall be settled" through arbitration.[43] The agreement also required that the arbitration be conducted pursuant to the rules of the AAA, which contain a very broad grant of power to arbitrators. There was no choice of law provision and, in fact, both parties agreed that federal law controlled. The issue was framed as it was in the previously mentioned cases: when the agreement has specified that disputes shall be settled through arbitration, did the parties intend that punitive damages be included?

The *Raytheon* court conducted a two-pronged analysis of the issue.[44] First, the court discussed differences between labor arbitration and commercial arbitration.[45] The court distinguished those cases on the ground that a different policy was being served in the labor context.[46]

Second, the court analyzed the approach of other courts. The First Circuit discerned three approaches to this issue. The first approach, the *Garrity* approach, posits that punitive damages are a sanction left only to the courts.[47] The court also noted the criticism surrounding *Garrity*. The second approach, adopted by an intermediate California court, allows punitive damages only if the agreement provided for this remedy.[48] Ultimately, the court endorsed a third approach, exemplified by the *Bonar* decision of the Eleventh Circuit. Since the court could find no other federal circuits to the contrary, and because it found the Eleventh Circuit's reasoning persuasive, the First Circuit joined the Eleventh Circuit in

41. Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983).

42. 882 F.2d 6 (1st Cir. 1989).

43. *Id.* at 9.

44. *Id.* at 10-12.

45. *Id.* at 10.

46. *See infra* Section V for differences between labor and commercial arbitration.

47. *Raytheon*, 882 F.2d at 11.

48. *Id.*

sanctioning the award of punitive damages by arbitrators when the arbitration is governed by the FAA.[49]

D. Second Circuit Reaffirmation - Barbier v. Shearson Lehman Hutton

The Second Circuit has recently reaffirmed its anomalous position on the issue of arbitral awards of punitive damages in *Barbier v. Shearson Lehman Hutton*.[50] The court decided the *Barbier* case upon narrower grounds than *Fahnestock*, but the *Barbier* decision serves to demonstrate the polarity of the Second Circuit's position. In *Barbier*, the plaintiffs alleged that Shearson Lehman and Bendelac, one of its brokers, breached their fiduciary duties, converted plaintiffs' money, and breached the contract.[51] The dispute was arbitrated and the N.Y.S.E. panel found grounds for an award of punitive damages.[52] A pertinent fact regarding the agreement was the presence of a New York choice of law provision (which is what really separates this case from *Fahnestock*).

While the district court upheld the award of punitive damages on the ground that the parties intended to include such an award as part of their agreement to arbitrate,[53] the court of appeals differed. The Second Circuit found this case to be an easier one than *Fahnestock* because there was an explicit choice of law provision. The district court termed *Garrity* "arbitration law" and could not conclude whether the choice of law provision meant to include arbitration law. The district court looked for other extrinsic evidence of intent.[54] The circuit court, however, viewed the choice of law provision as proof that the parties did not intend for punitive damages to be available.[55] By choosing New York law, the parties intended to be bound by *Garrity*. The court reiterated its interpretation that the FAA is not in conflict with *Garrity* and went on to say that this case was actually consistent with the spirit of the FAA. That is, the court was more than willing to enforce the agreement to arbitrate, but it would decide substantive questions of law, such as the availability of punitive damages, according to *Garrity*.[56]

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49. *Id.* at 12.

50. 948 F.2d 117 (2d Cir. 1991).

51. *Id.* at 119.

52. *Id.*

53. Barbier v. Shearson Lehman Hutton, 752 F. Supp. 151, 164 (S.D.N.Y. 1990).

54. *Id.* at 156.

55. *Barbier*, 948 F.2d at 122.

56. *Id.*

IV. THE FEDERAL ARBITRATION ACT (FAA) - SUPREME COURT INTERPRETATION

The FAA was designed to make parties comply with their agreements to arbitrate. A steady trend of Supreme Court cases have upheld and expanded this policy in order to encourage the arbitration of disputes.

The first case which had an impact in this area was *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*,[57] where the Supreme Court held that a claim of fraud in inducement to contract was arbitrable under the FAA. The thrust of this decision, as well as those that follow, is that issues are arbitrable unless the parties expressly exclude them.

Moses H. Cone Memorial Hospital v. Mercury Construction Corp.[58] represents the Supreme Court's understanding that Section 2 of the FAA created a "body of federal substantive law of arbitrability, applicable to any arbitration agreement" which it covers.[59] This decision announced that the FAA preempted state substantive and procedural law to the contrary.

In *Southland Corp. v. Keating*,[60] the Supreme Court allowed the arbitration of claims which arose from statutory law that indicated such claims would be determined judicially. Shortly after this decision, the Supreme Court extended *Southland* by requiring arbitration of state securities claims that were pendent to non-arbitrable federal securities claims in *Dean Witter Reynolds, Inc. v. Byrd.*[61]

The Court has consistently extolled the public policies behind the FAA. The FAA requires federal as well as state courts to give a liberal construction to agreements to arbitrate, and it also represents a congressional intent to compel arbitration of issues arguably covered by the agreement. The definite trend is toward expansion of the FAA's coverage.

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57. 388 U.S. 395 (1967).

58. 460 U.S. 1 (1983).

59. *Id.* at 24.

60. 465 U.S. 1 (1984).

61. 470 U.S. 213 (1985).

V. THE LABOR CONTEXT V. THE COMMERCIAL CONTEXT - DIFFERENCES

A. Labor Context

The trend in the arbitration of labor law cases has been to allow arbitration of punitive damages issues only when the contract explicitly authorizes such power. The rationale for the distinction between labor and commercial arbitration lies in the nature of the process in which labor arbitration arises. Since labor arbitration is only part of a larger collective bargaining process in many cases, there is a distinct need to preserve a relationship conducive to future amelioration of disputes between the parties. Punitive damages in this context may undermine a good working relationship that is necessary for parties to continue to resolve their dispute privately.[62]

The fear is that arbitrations resulting in the award of punitive damages will destroy the confidence that companies and the unions have in the bargaining process. This destruction arises from the nature of punitive damages as a severe reprimand denoting unconscionable conduct. The cases which have disallowed the arbitration of punitive damages in the labor context frequently invoke this rationale in support of their position.

B. Commercial Context

Arbitration conducted in the commercial setting differs from labor arbitration primarily because it is a "one-shot deal." The fears attendant to the award of punitive damages in the labor context do not exist in the commercial context because the commercial parties have chosen this forum as a "'simpl[e], informal[], and expeditio[us]' method of resolving a particular dispute."[63] The arbitration is not part of a greater process of ameliorative resolution with an intrinsic value of its own -- commercial arbitration is merely a quick, inexpensive resolution of one dispute.

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62. *See* Raytheon v. Automated Business Systems, 882 F.2d 6, 10 (1st Cir. 1989).

63. *Id.* at 11 (quoting Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, 473 U.S. 614, 628 (1985)).

VI. DISCUSSION

A. Conflicting Circuits?

Is there a conflict between the Second Circuit and the other federal circuits that have considered arbitral awards of punitive damages? A close reading of *Fahnestock*[64] and *Barbier*[65] discloses that the Second Circuit does not think so. It believes that its decisions can be reconciled with the other circuits on the facts. *Fahnestock* and *Barbier* involved agreements that did not incorporate the rules of the AAA (which have been construed to provide for the award of punitive damages). The other circuits confronted only agreements that included AAA arbitrations, while the Second Circuit has dealt mainly with N.Y.S.E. arbitrations for which the agreements to arbitrate lack the expansive grant of powers to the arbitrator which the AAA contains.

However, the underlying logic used by the Second Circuit to justify the *vacatur* of punitive damages awards belies its confidence in not being in conflict. Several notions that the Second Circuit used in the course of the *Fahnestock* and *Barbier* opinions disclose that its conception of how to evaluate the power of arbitrators is different from that of the other circuits.

The first clue in discerning the Second Circuit's rationale is its constant reference to diversity jurisdiction as the basis for hearing the case.[66] The court claims that because it hears the case based solely on diversity as subject matter jurisdiction, the FAA is not in conflict since it represents substantive federal law only insofar as it regulates and enforces agreements to arbitrate. The FAA's purpose is to bolster agreements to arbitrate,[67] but it does not represent independent federal question jurisdiction. Thus, the court must look to state law for the resolution of the substantive issue of punitive damages: "[I]n a diversity action, or in any other lawsuit where state law provides the basis of decision, the propriety of an award of punitive damages for the conduct in question . . . [is a] question[] of state law."[68]

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64. 935 F.2d 512 (2d Cir. 1991).

65. 948 F.2d 117 (2d Cir. 1991).

66. *Fahnestock*, 935 F.2d at 518.

67. Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1984).

68. *Fahnestock*, 935 F.2d at 518 (quoting Browning-Ferris Indus. v. Kelco Disposal, Inc., 492 U.S. 257, 278 (1989)).

B. Second Circuit Approach

The Second Circuit seems to view the FAA as substantive preemptive law only when the issue is whether an agreement to arbitrate will be enforced, but not preemptive on the issue of how the agreement is to be construed. Its analysis appears to proceed in this fashion:

1. Does the agreement specify that punitive damages are available? If yes, then possibly enforce it. If not, then proceed to #2.
2. Is there federal substantive law on point? No, the FAA is substantive only on issues regarding the enforcement of agreements to arbitrate.
3. Therefore, state law on punitive damages applies -- *Garrity* commands that arbitrators are powerless to award punitive damages so the arbitrator has exceeded his/her power.

The key to this analysis is the first step. If the court can construe the agreement to be completely silent on the availability of punitive damages, then it can proceed to *Garrity*. This is how the *Fahnestock* opinion can be harmonized, on the surface, with decisions of the other circuits; the other courts have not had to go past step one. In those cases, the rules of the AAA were applicable, and thus the agreement itself provided for the punitive damages. Furthermore, Supreme Court precedent on the FAA enables courts to override state law on this because the issue is one of enforceability of the agreement.

While the N.Y.S.E. rules of arbitration are admittedly less expansive than those of the AAA in their grant of power to arbitrators, the court should not have ended its analysis of whether punitive damages are included in the agreement at this juncture. The court has overlooked the abundant Supreme Court precedent which sets forth the rules of construction when an agreement to arbitrate is evaluated: "[A]mbiguities as to the scope of the arbitration clause [are] resolved in favor of arbitration."[69] Also, "as with any other contract, the parties' intentions control, but those intentions are generously construed as to arbitrability."[70] One more caveat: "[A]ny doubts concerning the scope

69. Volt v. Info. Sciences, Inc. v. Board of Trustess of Leland Stanford Junior Univ., 489 U.S. 468, 476 (1989).

70. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, 473 U.S. 614, 626 (1985).

of arbitrable issues should be resolved in favor of arbitration."[71] Mahoney, in his dissent in *Fahnestock*, picked up on this analysis.[72]

A second point on the court's "construction" is that in *Fahnestock* the majority was unwilling to view the N.Y.S.E. form, which provided for punitive damages, as probative on the issue of contractual intent, thus evidencing the court's cursory search into whether the agreement contemplated punitive damages awards. The court seemed to note the difference between the AAA provisional grant of power and the N.Y.S.E.'s relatively narrower endowment as dispositive on the issue.

Third, the court twice hinted that even if the agreements had specifically provided for the award of punitive damages, the court was still not certain that *Garrity* would be overruled: "We emphasize that an agreement between the parties specifically to award punitive damages *may* well have dictated a different outcome."[73] This indicates that the court is hesitant to agree that the FAA represents substantive law which would apply to enforcement of the parties' private agreement to arbitrate punitive damage claims.

The fourth point on the court's interpretation of the agreement arises out of choice of law discussion. In *Barbier*, the court emphasized the choice of law provision in the agreement to arbitrate, determined that this precluded the *Fahnestock* drill, and ended the analysis at step one. That is, the choice of law provision evidenced a clear intent by the parties to exclude punitive damages claims from the scope of the arbitrator's power. The Second Circuit in *Barbier* was willing to look beyond the agreement to arbitrate, but in *Fahnestock* it was not. The difference is that by looking beyond the agreement in *Barbier*, the court reached the *Garrity* rule that it desired to employ.

In addition, the Second Circuit seems to hold the presumption that punitive damages claims are deemed excluded unless otherwise provided for: "Clearly, if the NYSE wanted to empower arbitrators to award punitive damages, it could have done so."[74] The contrary is true in the other circuits where the Supreme Court's recommendations on construing agreements in favor of arbitrability are the assumed basis from which to proceed.

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71. Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983).

72. *Fahnestock*, 935 F.2d at 521 (Mahoney, J., dissenting).

73. *Id.* at 518. At another point in the opinion, the court stated: "If the parties had agreed to permit the arbitrators to make such an award, federal arbitration law *might* require confirmation." *Id.* (emphasis added).

74. *Id.* at 516.

VII. CONCLUSION

The Second Circuit's *Fahnestock* decision marks the advent of confrontation with the FAA and Supreme Court precedent, as well as with other federal courts. While *Fahnestock* can arguably be harmonized on its face with current arbitration law, serious undertones of the court's decision reveal a proclivity to apply New York's *Garrity* rule over federal law to the contrary. The court's apprehension and hesitancy over the outcome where parties expressly agree to arbitrate punitive damages evidences a misunderstanding of the proper approach to the resolution of issues of arbitrability of punitive damages.

Judge Mahoney, in dissent, correctly points out the faulty reasoning employed by the majority in *Fahnestock*. The two major faults revolve around construction of the agreements to arbitrate and the correct status to be accorded to the FAA.

The proper procedure for a reviewing court in this situation is first to examine the agreement to arbitrate. If there is an express provision authorizing the award of punitive damages, then the analysis stops, and the strong federal policy of enforcing parties' agreements to arbitrate dictates that the award is within the arbitrator's power regardless of state law. If the agreement explicitly rejects the grant of authority over claims of punitive damages, then that agreement should be heeded. If the agreement does not expressly contain such a provision, then the court must make an inquiry into the intent of the parties: did they contemplate the inclusion of punitive damages claims?

If the parties' intent cannot be determined, the court should construe the agreement in favor of arbitrability according to the precedent set forth by the Supreme Court. The federal policy which underlies the FAA indicates a congressional intent to foster the private resolution of disputes, and any ambiguities should be resolved in favor of such private resolution.

Michael L. Collyer